DOW THEORY LETTERS INC.

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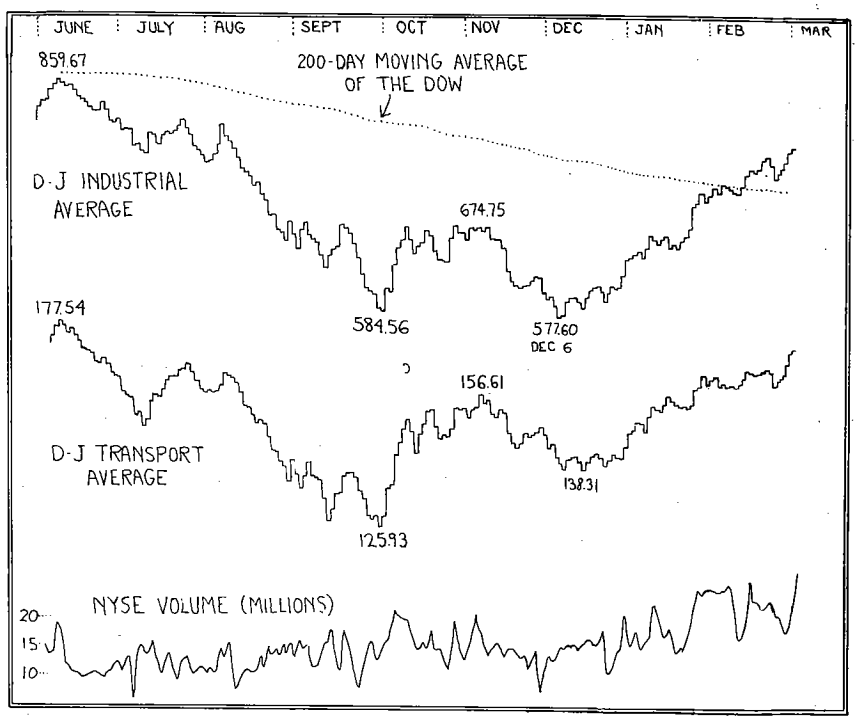
Feb. 21, DJIA 749.77; PTI 459; A-D ratio -29.03
Feb. 28, DJIA 739.05; PTI 453; A-D ratio -29.47

OVERHEARD: Last night I woke up, and I could have sworn I heard these two good old boys from Big Springs, Texas discussing the market (for the New York viewpoint, just change the accents). Listen, Roy-Gene is talking: "Ah got a list right here, Harley, and ah tell you, if ah can get just half this list ah'm goin' into this market with both feet." Harley: "Le's heah it, man." Roy-Gene: "Ah want a good market reaction down to 680-690, ah want an end to the dang Ah-rab-Israeli war, ah want a bust in the oil price, a tax cut, ah want the three investment services ah swear by to turn bullish, and ah'll clue ya, what I want most is a little good news in th at mornin' paper. By God, ah'm tired a'readin' about the country goin' under. It roils mah stomach when ah read it, man." Harley: "Well, that list don' sound too out a line to me, Roy-Gene. But you goin' have to pay a little more for stocks if all that stuff comes true." Roy-Gene: "Ah don' care, Harley, ma stomach's squinchin' around enough now, without worryin' about stocks. But ah tell you, as soon as mah list even start to come through, ah'm goin' in there man, ah'm goin' in heav-eee!"

THE WORRIES: Worry 1: This is a bear market rally exactly like 1930. Answer: You can almost take a contrary opinion on this one. I first talked about the great 1930 upward correction years ago, in Letters written during 1962. Now everybody is miraculously an expert on 1930. First of all, 1930 represented a normal rebound following an unprecedented two-month crash. One of the surest phenomenons in the market is the 50% rebound following any true crash (both in an individual stock or an average). The 1930 upward explosion was such a move. The 1974 bottom occurred following a long decline (two years) from the January, 1973 peak of 1051 on the Dow. The 1975 advance (confirmed bull market) does not look like an automatic rebound to me. It has the appearance of a return by the market to values, following the longest slide in the advance-decline ratio (the A-D topped in 1956) in stock market annals.

Worry 2: The monetary system is suddenly going to crumble, gold is going to shoot sky high, and everyone's going to be left holding worthless stocks and paper. Answer: I don't see it now. I think we are moving into a period of declining inflation. The only thing making gold bullion look even "passably good" at this time is the declining dollar. Against other currencies, gold has been singularly unimpressive of late. If world currency was on the verge of collapse gold would be climbing against all currencies. It is not. Furthermore, if we were near a monetary crisis, why would my chart of gold share relative strength be cracking? Would the market be that ignorant of what is going on!

Worry 3: The market has gone up too fast and too far. We're going to have a smashing correction to Dow 675-690. Answer: This one is just a guess, and anyone's guess is fair in the market. But remember this. The great majority of analysts totally missed this bull market. They want a big decline now so that they can tell their readers, "C'mon, you haven't missed anything. It looks safer here at 675 than it did at 590 back in December. This is the time to buy." In other words, those who missed this advance want another chance to buy. They may get that chance, but they may have to sweat a bit more first. We could correct here, perhaps on a milder basis, or we could go well over 800 and then enter into a larger correction. The market always obliges the fewest number of people. And the market always manipulates our emotions. Conclusion on this one: Almost everyone I read is now calling for a correction from the 750 level. The market will either (1) go higher or (2) provide a "too mild" correction.



Worry 4: War is imminent in the Mid-East. Answer: Imagine, and the market probably hasn't begun to discount that possibility. Poor, ignorant Wall Street.

Worry 5: The market is kidding itself, we're going into a deepening depression. Answer: I've probably

answered this one a dozen times, but here goes again. The market discounts everything except those very rare Acts of God. I interpret the market as having said that the primary trend turned bullish in October, 1974. The primary trend of business and the stock market always correspond. Either my interpretation of the bull market is wrong or there is no depression looming on the horizon. Actually, I believe most people are being blinded by today's unemployment, which the newspapers are blowing up to a depression-like spector. But people forget that 6-7% unemployment used to be considered normal. When the real depression ultimately arrives, we'll look back on early 1975 as the boom days!

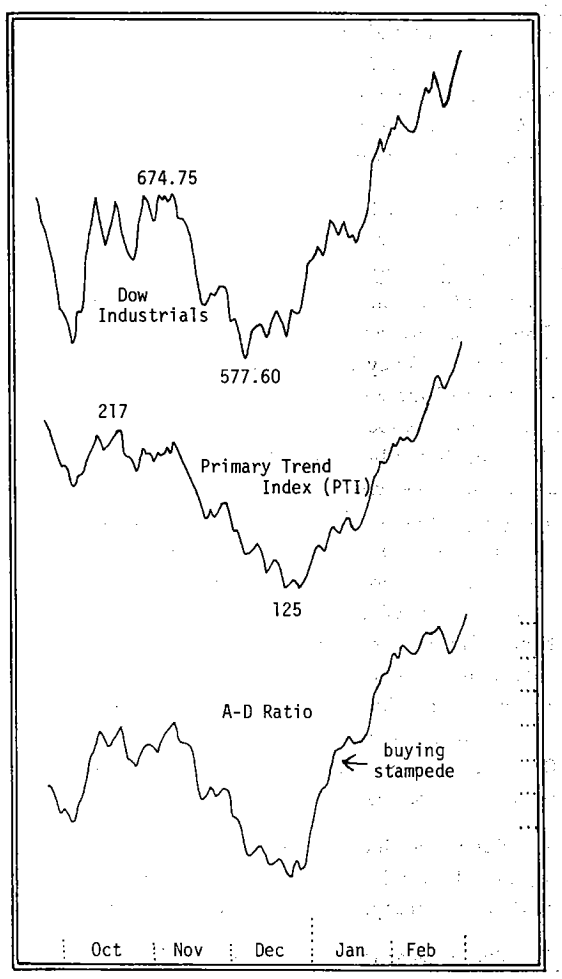
Worry 6: There's been much too much speculation on low-priced stocks on this rise. A real bull market should have begun more cautiously. Answer: Carloads of yesterday's blue chips are now selling under $20. That's one reason for the move in so-called low-priced stocks. Let's face it, Westinghouse, Woolworth, and Chrysler are not junk stocks, they're just cheap and experiencing rough times. Secondly, there's no picture-book bear market bottom and bull market beginning. If there was, you wouldn't have to think or interpret. Every new bull market has its quota of foolers as does every new bear market. If you're looking for THE FORMULA, my advice is to exit gracefully and permanently from Wall Street. Formulas are for chemists, but you'll never beat Wall Street with them.

Worry 7: As soon as inflation starts boiling again, the Fed will tighten the money screws and it's curtains for the market. Answer: Commodity prices have been caving in during 1975 and right up to date. That's hardly a sign of inflation, as is the sagging gold price. The bullish factor for the market is that inflation is subsiding. Rising prices could be a dead issue for the rest of 1975. This would be bullish for the purchasing power of the dollar and the value of dividend paying stocks. I don't expect inflation to be an issue for quite a while, and we can thank the recession for that.

Worry 8: How could so many leading stock market experts be wrong about this bull market? I note that a large number of advisories are still skeptical. Answer: Just as the bear market that ended in 1974 kept going until it destroyed the credence of the last stubborn bull, this bull market could plow ahead until it has destroyed the last bear. It is that very skepticism that has kept this market technically powerful. When I turned bullish in December, 1974, quite frankly, I was scared, and I knew that I stood almost alone. I also knew that I was putting my business literally on the line. But I did the same thing in 1957-58 and again in 1966 and thereafter, so I suppose some day I will get used to it (I don't really believe that, of course).

CURRENT PICTURE: Amid much talk about a "non-confirmation" on the part of the D-J Transportation Average, the Transports jumped to a recovery high of 163.80 (see page 1 chart). Taking the cue, the Industrials on March 3 lept to a recovery high of their own (closing at 753.13). A marked increase in volume accompanied the new bull market highs, and March 4 saw a continuation of this extraordinary advance.

As of this writing, the investment stampede (see Letters 619 through 623) remains intact. The stampede is now in its 48th day. I explained in previous Letters that as long as any decline in the advance-decline ratio holds to less than 1 full point, the stampede will be considered in force. On February 21 the A-D touched a recovery peak (see chart) followed by a two-day decline (Feb. 24 and 25). The sharp decline took the A-D ratio within 2 one-hundreths of a point of a full 1 point correction. Incredibly, the market turned up on February 26 with the investment stampede having held together by the merest fraction. On March 4 the A-D ratio recorded a new recovery high! In all, 1975 has provided a remarkable technical performance.



The Primary Trend Index (PTI), which is my own composite of eight leading technical indicators and Averages, has worked outstandingly well in the latest period. The PTI hit a new bull market recovery peak on February 27, 28 and on March 4 and 5. These readings took it to the highest level in five months. So far, the PTI is acting in exactly the opposite manner in which it acted during the last bear market in that it is leading the market up in the face of any and all minor jiggles, hesitations and consolidations.

IMPORTANT: I included the parody in the first paragraph as a well-meaning way of poking fun at the bears, the late-comers and the pompous "experts" who have argued with the market all the way up. Nevertheless, subscribers know my adage, "If you're not sweating, you're not buying right." At this stage of the game, I think people are buying without too much sweating. It feels a lot "righter" buying now than it did when we bought them in December and early January. This bull market is a powerhouse, and it is true that primary movements can do anything. The huge bull movement from April through December, 1958 developed with only three minor and rapid declines. The great bull swing from October, 1963 to May, 1963 went along with only one minor decline. We could be on the same kind of incredible trip now.

But the powers above don't design Wall Street to be a lead-pipe cinch for Richard Russell or his subscribers, and although we don't know exactly when — this market WILL ULTIMATELY CORRECT. I'll stake whatever reputation I have in Wall Street on that. When it does correct, the Dow could undergo the normal 1/3 to 2/3 retracement of the preceding primary swing. The rise since the bear market low of 577.60 (December) has not so far been corrected, and we should remember that (see page 1 chart).

For example, let us suppose that the Dow advances uncorrected to 835. That would be 258 points above the Dow bear market low of 577.60. If the Dow then suffered only a mild 1/3 correction, we could see a value of 749 for the Average (a 50% correction would take the Dow to 706). In other words, a 1/3 correction from 835 would take the Dow below current prices. I insert this thought as a way of saying to readers, "Cool it, don't get greedy, the market is always there. We'll have bull and bear markets a year, five years, a dozen years from now. You don't have to chase the market (although the market would like you to).

And if you start to feel the virus of greed, there's one sure cure. Take a few profits, sell a few shares, leave a little for the next guy. We sweated with our quota of fear when we bought our shares, so maybe give a few shares to the fellow who is now sweating out of greed.

CHEAP STOCKS: Stock prices are subject to cycles based on psychology (sentiment) or how much people are willing to pay for earnings. Actually (although most investors seem unaware of it) the sentiment factor is a much greater swing factor in the price of stocks than are the actual earnings.

The simple and logical way to check on market sentiment is to study the price-earnings ratios. I watch these ratios very carefully in the case of the Dow Industrials (1) because the Dow is composed of investment-grade stocks, and the P/E ratio on those stocks is indicative of informed investor sentiment, and (2) because a long, accurate history of the DJIA is available.

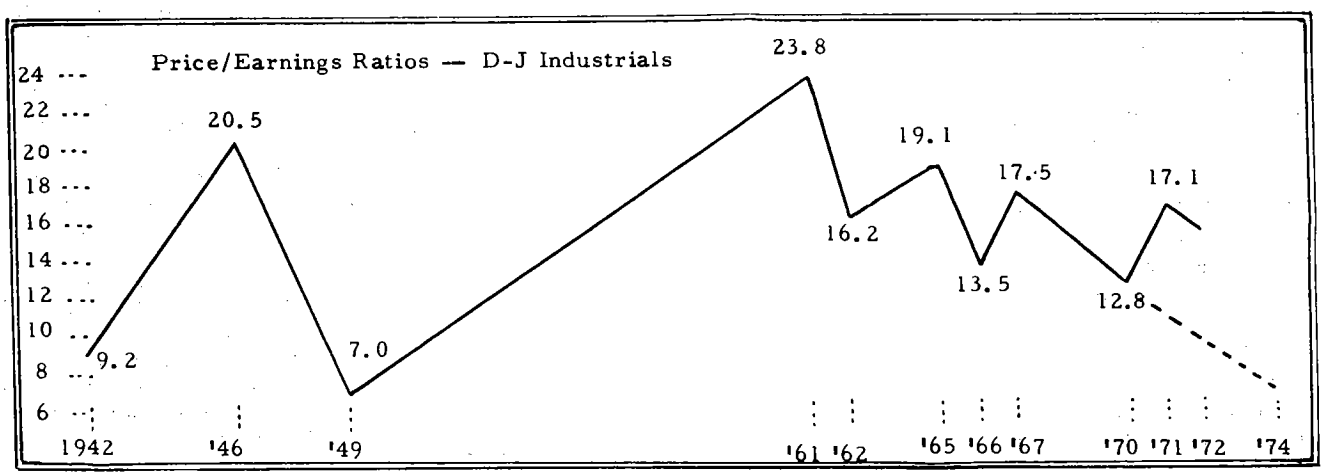
In Letter 545 (December 1, 1972) I published a piece on the Dow and its P/E ratio. I included a chart, and I am presenting that chart again — exactly as it appeared in Letter 545. In that mailing I reviewed some past history of the Dow P/E ratios. I noted that the 1942-46 bull market began with the Dow selling at a P/E ratio of 9.2. By 1946 (see chart) investor sentiment had improved tremendously, and the P/E ratio for the Dow had climbed to 20.9.

Next came the August, 1946 market crash and a confusing and discouraging series of rallies and declines to the 1949 Dow low of 161.60 in 1949. At that time, while the public expected "the great post-War depression," the Dow sold at an extraordinary 7.0 times earnings. During the next 12 years pessimism vanished and optimism increased.

Many of you undoubtedly remember the almost universal talk about the "Soaring Sixties." Actually, the two things that soared in the sixties were the P/E ratios, which topped out in 1961, and the national debt, which just kept on climbing. By 1961 investors were paying an astounding 23.8 times earnings for the Dow. That was it — the peak.

What followed was a long series of descending peaks in the Dow P/E ratios. Regardless of increased earnings, the investor optimism of 1961 was not again revived. In December, 1972 I drew this chart and I wrote as follows: "Here is my guess regarding how this bear market could end. The rise from the 1949 low of 7 on the Dow P/E to the 1961 high of 23.8 took roughly 12 years. If it took roughly another 12 years or so to run the full cycle down, we might expect a low on the Dow P/E ratio sometime during 1973 or 1974. It might even take another year, since the Government is mounting the greatest campaign to produce optimism I have ever seen." (Note: that campaign gave way to Watergate).

I continued: "At any rate, assuming the bear market produces its lowest P/E ratios during the 1974-75 period, it would not surprise me to see those ratios back in the 7 to 10 area (or around those that existed during 1942-49)...."



I could not, of course, foresee Watergate and the consternations it caused, nor could I foresee the Arab oil price boost. These had the result of reducing investor sentiment to the point where the Dow, at the lows of December, 1974 sold at an incredible 6.0 times earnings. That was actually lower than 1942 or 1949! And if that low P/E didn't reflect investor gloom, and if that P/E ratio of 6 did not fully discount a mountain of troubles, I don't know what would have. The extraordinarily low P/E of 6 also helped us to call the bear market bottom.

TECHNICAL NOTES: The moving averages of the Dow are slowly coming together (see Letter 620, page 3). The 13-week MA has now climbed to 661 (from its December bear market low of 625), while the long-term or 50-week MA has dropped to 723 (from its 1973 peak of 963). This means that the two MA's are 62 points short of a crossing. At their worst, the two MA's (on December 12) were 133 points apart, so we can see that they now have halved the distance.

A crossing of the 13-week MA above the 50-week MA provides us with a long-term buy signal under this study, and it is interesting to note that the greatest part of past bull markets have come after a crossing. We should also remember that because of the take-off figures used in computing the MA's, even if we now get a correction, the two MA's will probably continue to move towards each other. Subscribers will be notified as soon as a crossing is imminent.

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The broad S & P 425 Industrial Average closed out the month of February at 91.16. Referring to the chart (that first appeared in Letter 620, page 4), we see that this gives a momentum ratio of 84.9 when compared to the year ago figure. We now have a reversal of the downward trend in momentum that has held in force since the 1971 peak. This kind of reversal in momentum usually lasts for two or more years (regardless of the inevitable corrections). (See chart at bottom of page).

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I thought the following, from Dan Dorfman's excellent column ("The Bottom Line") from the latest New York Magazine, was most fascinating. (See right side).

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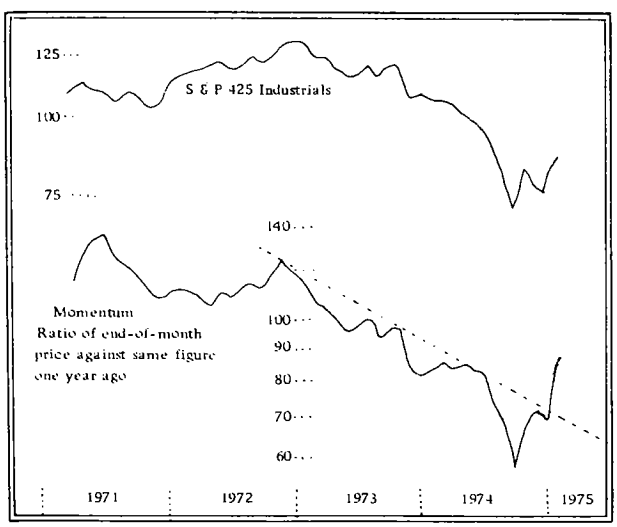
Bill Gordon from Florida sent me his latest computation on the short interest for the 30-Dow Industrials up from January's record 1.894 million to a new February (record) total of 2.633 million shares. This is an astounding 39% jump in the total short interest for the Dow stocks in a single month! Talk about speculating for the decline....!

GOLD, ARABS, MONEY, THOUGHTS: The Arabs just don't want gold. They have a money lender's psychology (banker's psychology if you wish), and you can show them the logic of gold, you can rant, you can cajole, you can wait, but I'll tell you a secret: THEY DON'T WANT GOLD. They don't want it because they can't control the gold price, and wealthy men always want control. The Arabs don't want gold because it doesn't pay any interest, and bankers and money lenders want a return of their capital.

The Arabs know values, or they at least hire men who know values. I believe the Arabs have stumbled upon the Great Secret. The Secret is that the two most undervalued items in the world today are (1) US common stock shares, and (2) dollars. I won't go over why stocks are cheap; I've been explaining why in every report of the past three months. The dollar is cheap because it's been "overdone" on the downside. It's gone down too far against other currencies in the past few months. My guess is that the dollar is scraping along the bottom, and it will soon be a buy (against other currencies).



And when the dollar hits bottom, I believe we are going to see a rush by foreign dollars' holders (Arabs, Euro-

The prevailing opinion on Wall Street is that the little guy, not the big institutional investor, has been the driving force behind the market's rally. Well, it's just not so. In some statistics provided by New York Stock Exchange research chief Stan West, it's clear that the little investor, for the most part, has been on the sidelines. Here's the evidence:

☐ The odd-lotter (the buyer of less than 100 shares of a stock) was a net seller in January, a month in which the Dow Jones Industrial average rose about 14 per cent. And in the three-week period that ended February 21, the odd-lotter continued to be a heavy net seller, unloading stocks in fourteen of the fifteen trading sessions.

☐ In December, transactions on the Big Board tape of 100 shares (another reflection of buying by relatively small investors) accounted for 47½ per cent of all tape transactions. But in the last week of January and the first two weeks of February, a period of sharply rising stock prices, the 100-share transactions had fallen to around 41½ per cent of the action.

☐ On February 13, the biggest volume day in the Big Board's 182-year history (35,160,000 shares changed hands), there was a lot of talk on Wall Street that the little guy was leading the way. He wasn't. On that day, block trades of 10,000 shares or more (indicative of institutional activity) totaled 273, the Big Board's largest tally ever for a single trading session.

Many small investors, it's true, speculated on low-priced stocks (below $10 a share) when the market perked up early in 1975. But a look at the recent prices of the most active stocks on the Big Board roster clearly confirms the domination of the market by institutional investors. We get this too from Stan West, who points out that in the week that ended last February 21 (a week of continued market progress), the average price of the twenty most active Big Board issues was a shade above $38 a share. That's hardly the kind of merchandise for mass consumption.

peans) to buy US stocks. That's going to be one of the "kickers" in this bull market. The fact is that the Arabs and the Europeans want it — and they're not in yet. Last week I received a call from a broker in Switzerland, and the jist of his comments went as follows: "We're ready to buy American stocks aggressively. All we want is a bottom on the dollar and, please, a reaction in the market."

Now here's another concept. The rate of inflation is coming down. Mr. Ford and the Congress are not really getting together on very much, which, ironically, is bullish for America. The less they do, the less the odds that they will botch things. This economy is getting ready to scrape bottom, and the declining rate of inflation is very bullish for the stock market. The declining inflation rate means (1) that the dollar will (in time) be worth more, or at least it will stabilize, (2) it will be safer to own dollar-stocks (i.e., US stocks), and (3) that the bull market will be prolonged. To reverse the idea, I would say that the quickest way to blow this bull market up and then kill it would be roaring inflation again.

Remember, one of the prime reasons for buying gold shares over past years was the spector of accelerating inflation. I believe the gold shares now "see" the deceleration of inflation, and for this reason they are stalling or coming down. Without an inflationary boom ahead, without a monetary crisis ahead, without a debt collapse ahead, the rationale for holding gold decreases considerably. Gold becomes a "far in the future" play (don't get me wrong, the rationale is still there, but the rationale for holding common stocks supercedes it).

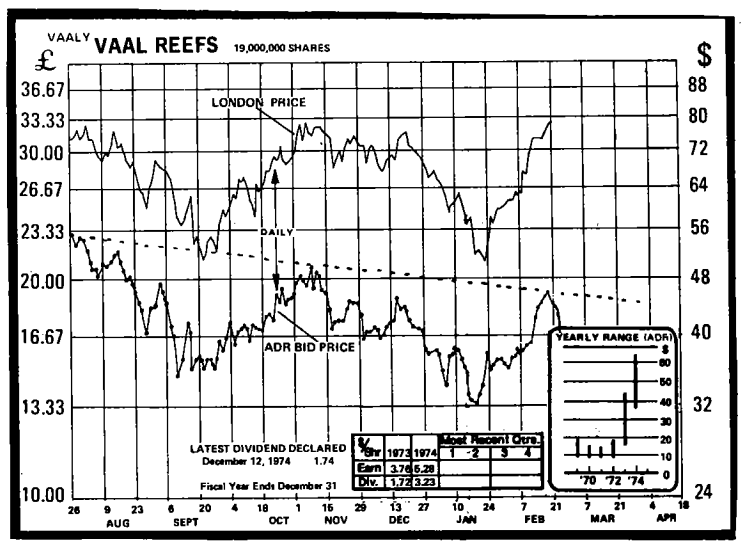
Now I'd be the first to admit that informed investors don't accumulate common stocks simply because they have fallen 50% to 90% in a bear market. Investors have to believe the worst has been seen and that there's light at the end of the tunnel. Personally, I think the economy is nearing the bottom of its decline now, and that within a few months we will begin to see the bullish hints and hopes. But people believe what they want to believe, and right now pessimism is the fastest selling commodity around. Ponder this: A year ago people were telling themselves how bearish it was that prices were climbing into the clouds. Now, with auto rebates and lowered tickets, with Penney and other retailers cutting prices sharply, with price cuts and concession in many commodities and raw and finished goods, people are saying that it's all so bearish, "Nobody can hold their prices."

My response is: Bunk. Inventories are now coming down, although statistics do not yet show it. Corporations have been cutting away the fat, productivity will improve in the months ahead. But the great surprise could be profits. Mr. S. J. Levy (Box 26, Chappaqua, NY 10514) in his Industry Forecast just issued, writes as follows: "Profits in the first quarter of 1975 are falling sharply. However, forthcoming tax reductions will have a strong, favorable effect on corporate earnings. Profits will rebuild quickly and, for 1975 as a whole, be down no more than 10% from the previous year. Profits other than inventory profits will be close to last year. Before the end of 1975 business will be enjoying prosperity. Unemployment, meanwhile, will be high and it will be the nation's priority economic problem." I might add that Mr. Levy (Barron's favorite) probably has the best record of any economist in the US today.

In the March issue of the authoritative Bank Credit Analyst, J. Anthony Boeckh writes that his cyclical indicators are bullish and notes that his Cyclical Banking Liquidity Index has jumped from a January figure of 11.8 to a February figure of 142.5. "Rises like this have been rare in the 56-year history of the Index, the last being in July of 1970 when the previous bull market was getting underway. Such strength...has marked the beginning stages of all major cyclical bull markets since 1919."

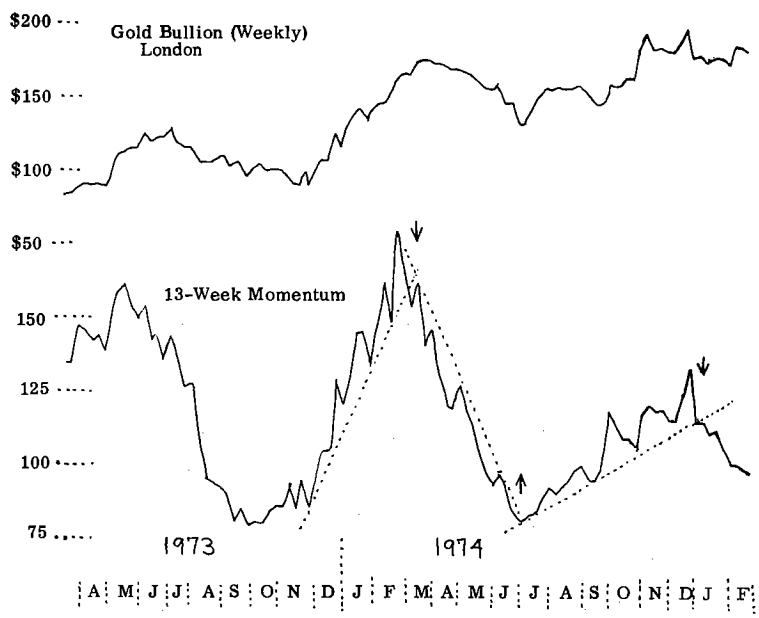
So two of my favorite analysts, both working from different directions, seem to agree with my own technical and fundamental opinions. I think we're in a primary bull market. You may disagree, but don't short it.

GOLD SHARES: I have included a running account of the gold shares in these reports. In the last Letter I showed how ASA and the listed golds have built a series of three descending tops (August, November, February), and I commented that I was suspicious of the move because there was no volume on the February-March rise. At the recent peak the golds did fizzle, and they then turned down. Underscoring all this was the breakdown in gold share relative strength as seen in the last report (HM), and since that mailing relative strength has deteriorated even further in the gold shares.



I am showing a daily chart of Vaal Reefs, one of the leading S. African gold mines, and here we see the August peak, the lower November peak and the still lower peak of a few weeks ago (February). I never care for this kind of action, particularly the kind in which a stock rallies up to its declining trendline (see chart), then turns down on increasing volume. I feel that the gold shares are in a bear market, and that there is at least one more major movement slated for the downside. This move (if I am correct) could take some or all of the gold shares to new lows. (Vaal chart courtesy of Kaffir Chart Service, Palisades Pk, NJ 07650).

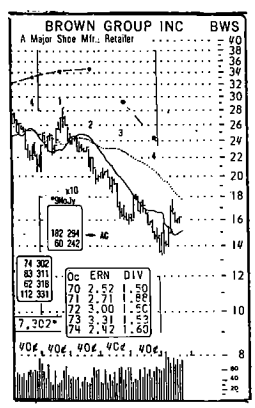
What happens then? At such time, I may recommend moving back into some gold shares again, but that's another story, and we'll have plenty of time for it.

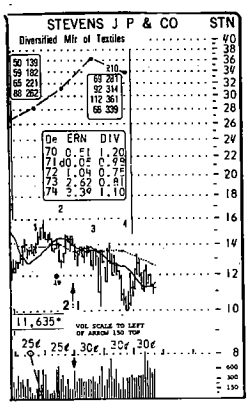


In the meantime, the price of gold has dropped below 80, and as seen on my bullion momentum chart, the yellow metal is now dropping below the 100 level on momentum. If the momentum cycles hold to form, we should hit bottom in momentum around mid-year. What the gold price will be then is only a guess. I will say this, that if gold breaks a trendline now coming in at 170 we are going to see a nasty drop in the price of gold bullion.

STOCKS: Well, I've recommended a lot of stocks since the first "bull Letter" or Special Report of December 20. Almost all of the stocks are up, I guess the biggest winner is General Cinema (recommended at 5) now up 240% and the percentages go all the way down to 5% - 10% gains. I can't imagine how anyone who purchased any cross-section of the issues recommended could fail to have a profit, and from Letters received here I would say that average profits run between 25% and 50%.

At this point, when people ask, "Is it too late to buy?" I say that no one in the continent of North America knows if it's too late, but I'll swear to one thing, it's a good deal riskier. After all, the Dow is up 32% in a period of 2½ months, and that's no mean feat. It amounts to about 185 points in six weeks. At that rate the Dow would be 1200 by mid-year, and I doubt if that is going to happen. If it does, I'm going to be more than a little worried, and I'll probably be going around with an umbrella over my head. So the point is that one's passion for stocks should decline as the market goes higher. Remember, only a few months ago all the stock market and economic experts were telling us that "the sky was falling in!"





For the man who has everything (in stocks, including some fat profits) you might look at the soft goods industry. I recommended Melville Shoe at 5 in December, and the stock has since doubled. The Brown Group (see chart) at around 16 represents good value. BWS sold for 61 in 1968 with the low of 13-3/8 coming in January, 1975. The dividend for BWS is $1.60 but with latest four quarters earnings at $2.42 and not yet bottoming out (at least there's a good chance they are not), it's a 50/50 bet whether they dividend will be held. Personally, I am guessing that the dividend will hold. If so, BWS yields a fat 10% on a good company (a major factor in shoes) with a book value of just under $30. I think the downside risk is very low on BWS.

A second softgoods "bargain" is J. P. Stevens, one of the great integrated textile companies. Stevens sold as high as 40 in 1966. At the 1971 and 1974 lows of 10, the stock of STN was at its lowest level on my records (going back to the 1940's). With a book value of $33 and working capital of $30, STN, it seems to me, is a very cheap number at the current price of just over 11. Last year's record earnings of $3.61 are undoubtedly coming way down. STN earned 31¢ for the quarter which just covered the quarterly dividend (that was not cut). If the dividend is maintained at $1.40, STN yields over 12%. I feel that there is a fair chance management will hold the dividend and that there is a good chance we are seeing the worst of STN earnings now. For those who feel venturesome, buying STN here seems to offer little downside risk (in my opinion), whereas if the stock goes up you'll be a hero holding a great US corporation for 33¢ on the dollar (figured on book value). Stevens has gone through a lot of hard times, and I don't think it's going under (and I'm not being facetious). Chart of BWS, STN courtesy of Quote, PO Box 213, Wichita KS 67201).

LATE NOTES: The market has been doing a lot of churning, there's no question about it. Volume of over 30 million shares (such as Mar. 4) with the Dow up only 4 points scares alot of the wise heads, because it means that despite the explosive volume, there are ample sellers for the eager buyers. At this point the market is giving everyone a reason to be scared or to sell or to take profits. What do we do?

If you bought early, I'd say sit tight or perhaps take a few profits just to prove to yourself that you are capable of doing it (most people aren't, or else they never have the profits to take). Later buyers are a problem, and I don't have THE answer. Technically (aside from churning) I can't find anything really wrong as yet. I have no real non-confirmations, but of course the market continues to be "overbought" as it has since early February. The "obvious" picture is that the market is building a top here. I tend to distrust the obvious.